

Controlling Expenses Too Important to Deal with Using Ad Hoc Approaches

Good expense management is essential for every insurance company. For some companies it can mean the difference between success and failure. For others it can be the difference between settling for being good when you could be great. Despite its importance, it is probably the most difficult and least favored of management's responsibilities. But it doesn't have to be. It may never make your manager's top ten list of "things I'd rather be doing" but we can take it off their "awful" list. So, how do you get everyone to do a better job of expense management while also making it something they willingly engage in?

We've worked on this problem for years. In our opinion, one of the best approaches is a three step process.

First, you need to make sure everyone understands what is expected of them. This means establishing your company's long term expense management goal. You do this by identifying and getting agreement on the expense ratio the company needs to attain each year for the foreseeable future. This goal should be more than just a number or a ratio. It should include the reasons why this expense level must be attained for the company to fulfill its mission and be successful. Having a long term goal instead of annual targets that change each year ensures that everyone understands what they need to plan for. It provides stability and helps everyone avoid overreacting to immediate concerns.

Once you have the overall expense goal for the company, you then need to translate this into the expense level that must be attained in each area within the company that has a budget and is responsible for managing expenses. This step is essential. It gives every area its own concrete expense goal that must be attained each year. Each area then becomes accountable for managing to this goal.

Establishing appropriate long term expense goals throughout the company can be done in several ways. The easiest (and least effective) approach is to give each department a number or percentage of the total company budget each year. The best approach is to establish "expense allowable formulas" for each department. These are formulas that are based on the pricing assumptions in the products you sell and the work that is done in each area. This approach is more difficult and might require professional assistance but it's worth it. For more information on how "expense allowables" are created, go to our website and visit the [Concepts and Ideas](#) section. We wrote a paper on this in 2002.

Accomplishing this first step takes the mystery out of budgeting and expense management. It sets both annual and long term expense goals that must be attained. It allows everyone to anticipate and plan in a logical, orderly manner. It focuses everyone on managing expenses properly, instead of spending time on how to negotiate for a higher budget number. It simply works better.

The second step is to provide help to those areas that cannot get their expenses lowered to the point where they need to be. This usually includes providing new management tools or assistance in maintaining these new expense levels. Following is a checklist of frequently seen problems that will cause high expense levels:

Inefficient work processes
Fragmented or poorly designed jobs
Multiple or poor computer systems
Too many system work-arounds

Too many managers
Lack of dual career paths
Inefficient organization structure
Ineffective results feedback

Be careful as you streamline and reduce costs, that you don't inadvertently sacrifice customer service or satisfaction. The best approach is always to focus on creating the best operation possible, not just the cheapest. Projects that just focus on creating expenses savings tend to make easy, temporary changes that only last for short periods of time.

You should also pay attention to the management tools that are available to ensure that efficient operations are maintained in the future. Interactive computer staffing models are especially useful. Staff expenses represent the largest cost in every operation and these models are very effective in assisting teams and units in their management and planning. If you'll visit our website you'll see that we've published several papers on this subject.

The third step in this process is to create an ownership culture within the company that gives each employee a reason to produce results that are consistently better than what is expected of him or her. This is by far the most important step . . . but it requires that the previous steps be taken for it to work.

The most effective "driver" in establishing this new culture is to introduce a "gainsharing" incentive compensation plan. This is a plan that treats all of your employees as owners of their results by allowing them to share in the financial benefits they create. This type of plan answers the question – What's in it for me? It is an essential step if you want to become a high intensity organization. You'll need professional help in designing this type of plan. Following are some guidelines that must be accomplished to create one of these plans:

- There must be a single overall design for the company but each plan must be specifically designed to meet the unique situation of each department or team.
- Plans are designed to reward employees for surpassing the core success measures for their team or department. This ensures payments are directly connected to core business results.
- The plan should be self funding. This means incentive payments are made from financial results (profits) that are beyond plan.
- Both the company and employees should share in these financial results, with the largest share going to the company.
- All employees should be eligible to receive incentive payments. Actual payments are earned based on team results.
- Incentive payments should be made quarterly. Annual payments may work for executives and management but they do not motivate other employees.
- Payments are made for team and department results. Paying for individual results doesn't work.
- Each specific team and departmental plan must encourage the behaviors each unit needs.

Gainsharing plans help create a culture where your employees are not satisfied with anything short of above average results. Can you imagine how frightening this will be to your competition? This is truly the definition of a world class business culture.

In our management consulting practice we help companies attain their full potential by creating naturally effective organizations. These are organizations that are so well designed that it becomes easy to be successful. This is our vision. It is what we do. Please visit our website (McDonaldConsulting-Group.com) if you want to learn more about our firm.